

Message Text

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ACTION EUR-25

INFO OCT-01 EA-11 ISO-00 AID-20 CIAE-00 COME-00 EB-11

FRB-02 INR-10 NSAE-00 RSC-01 XMB-07 OPIC-12 SPC-03

CIEP-02 LAB-06 SIL-01 OMB-01 L-03 H-03 PA-03 PRS-01

USIA-15 FS-01 ABF-01 NSC-10 SS-15 STR-08 CEA-02 DRC-01

EURE-00 /176 W

----- 062680

P R 111733Z SEP 73

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 3923

INFO AMEMBASSY BONN

AMEMBASSY CANBERRA

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY SINGAPORE

AMEMBASSY TOKYO

AMCONSUL HONG KONG

USMISSION OECD PARIS

USMISSION EC BRUSSELS

TREASURY DEPT WASHDC PRIORITY

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 10425

DEPARTMENT PASS FRB

E.O. 11652: GDS

TAGS: EFIN, UK

SUBJECT: COMMENT ON EXTENSION OF STERLING
AGREEMENTS AND EXPIRATION OF BASLE FACILITY.

REF: (A) LONDON 9997; (B) LONDON 10245; (C) LONDON 10246
(D) LONDON A-1131

1. EMBASSY HAS REPORTED DURING PAST SEVERAL MONTHS OF
DIFFERENCES OF OPINION WITHIN HMTREASURY AND BANK OF
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ENGLAND (REF A) CONCERNING WHETHER OR NOT TO EXTEND

STERLING AGREEMENTS. AFTER INITIAL ACTIVATION LAST OCTOBER, WHEN U.K. OBLIGATED TO MAKE UP DIFFERENCE BETWEEN \$2.3506 AND GUARANTEE RATE OF \$2.40, (ROUGHLY 60 MILLION POUNDS) SOME IN U.K. MINISTRIES ARGUED BEST FUTURE SOLUTION WOULD BE TO LET AGREEMENTS EXPIRE IN SEPTEMBER 1973. THERE WAS A FEELING THAT WITH STERLING FLOATING EVEN IN ABSENCE OF GUARANTEE, STERLING HOLDERS WOULD NOT RUSH TO SELL STERLING AND DRIVE STERLING RATE STILL LOWER.

2. WITH STERLING BOBBING LIKE A CORK, OTHER COMPLICATIONS IN RENEWAL OF AGREEMENTS INCLUDED HOW TO DEAL WITH A GUARANTEE ON A FLOATING CURRENCY, AND HOPEFULLY INCLUSION OF SOME RECAPTURE PROVISIONS SHOULD STERLING AGAIN GO ABOVE \$2.40 FOR A LENGTHY PERIOD. THIS WAS IN PERIOD (4TH QUARTER 1972) WHEN AVERAGE STERLING DEPRECIATION FROM SMITHSONIAN RATES AGAINST MAJOR CURRENCIES WAS A RANGE OF 11 PERCENT; U.K. TREASURY OFFICIALS CONSIDERED THAT AN EVENTUAL DEPRECIATION TO RANGE OF 15 PERCENT WAS MAXIMUM THAT COULD BE CONSIDERED, AND PROBABLY MORE THAN EC PARTNERS WOULD ACCEPT.

3. MAIN ARGUMENT IN FAVOR OF MAINTAINING STERLING AGREEMENTS WAS THAT IT WOULD BE UNWISE TO ALLOW THEM TO EXPIRE AND ADD MORE THAN THREE BILLION POUNDS TO INTERNATIONAL POOL OF FLOATING SHORT-TERM CAPITAL. THIS MUCH SAID, EVEN SUPPORTERS OF AGREEMENTS ACKNOWLEDGED (A) DIFFICULTY OF RENEWING OVER 60 BILATERAL TEXTS, INVOLVING AT LEAST THIRTY ACTUAL BILATERAL NEGOTIATIONS (ONLY 5 OR 6 OF WHICH MAJOR) AND (B) INCONGRUITY OF PAYING MARKET RATE OF INTEREST ON GUARANTEED HOLDINGS.

4. ARGUMENTS OF BANK OF ENGLAND CONVINCED HMTREASURY THAT SOME FORM OF EXTENSION WAS NECESSARY. AS ORIGINALLY PLANNED, CHANCELLOR WAS GOING TO SEND LETTERS THIS WEEK OFFERING EXTENSION OF STERLING AGREEMENTS IN FORM ROUGHLY SIMILAR TO THAT ANNOUNCED LAST WEEK (REF D). HOWEVER, NERVOUSNESS IN LAST WEEK'S EXCHANGE MARKET, WHEN WEIGHTED DEVALUATION EXCEEDED 18 PERCENT AND EVEN EXCEEDED 20 PERCENT, WAS IN PART BASED ON FEARS THAT HOLDERS MIGHT

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UNLOAD STERLING IN THE ABSENCE OF GUARANTEE. THIS FORCED U.K.'S HAND, LED TO U.K.'S PUBLIC OFFER LAST THURSDAY TO EXTEND THE AGREEMENTS FOR SIX MONTHS.

5. IN PRIVATE CONVERSATIONS, U.K. OFFICIALS INDICATE THAT EXTENSION OF AGREEMENTS COULD HAVE BEEN HANDLED BETTER. IN HINDSIGHT, EXTENSIONS PROBABLY SHOULD HAVE BEEN DISCUSSED AND SETTLED THREE MONTHS AGO, RATHER THAN

BEING ALLOWED TO COME DOWN TO THE WIRE WITHOUT SOME
INDICATION OF U.K. INTENTIONS. U.K. OFFICIALS SAY THEY
HAVE NO EVIDENCE THAT STERLING HOLDERS WERE INVOLVED IN
LAST WEEK'S ATTACK ON STERLING.

6. FROM SEPTEMBER 24, U.K. IS TO SOME EXTENT MODIFYING
AND SOFTENING AGREEMENTS BY ALLOWING HOLDERS TO INCREASE
ABSOLUTE SIZE OF RESERVES WITHOUT ENLARGING EXISTING
HOLDINGS OF STERLING. (SEE REF D.)

7. LOOKING AHEAD, U.K. OFFICIALS CLAIM THEY DO NOT KNOW

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WHAT FORM OF EXTENSION WILL BE OFFERED ON MARCH 24, 1974, WHEN THE SIX-MONTH EXTENSION RUNS OUT. GUARANTEE DOES NOT COVER ALL OFFICIAL LIABILITIES. IT DOES COVER OVER 3 BILLION POUNDS OF OUTSTANDING OFFICIAL LIABILITIES, WHICH IN TOTAL ARE NEAR THE 4 BILLION POUND FIGURE. (IN GENERAL, IT COVERS VALUE OF STERLING HELD BY COUNTRIES PARTY TO AGREEMENTS, SUBJECT TO A DEDUCTION EQUAL TO 10 PERCENT OF THEIR TOTAL OFFICIAL EXTERNAL RESERVES.) U.K. HOPES ANY FUTURE EXTENSIONS BEYOND SIX MONTHS AND MORE GENERAL QUESTION OF FUNDING OF STERLING BALANCES CAN BE CONFIDENTIAL

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SETTLED IN CONTEXT OF INTERNATIONAL MONETARY REFORM.

8. IN RELATED DEVELOPMENT, U.K. HAS DECIDED NOT TO SEEK RENEWAL OF THE \$2 BILLION MEDIUM-TERM BASLE SUPPORT LINES. U.K. OFFICIALS EXPLAIN THAT THESE ONLY BECOME OPERATIVE WHEN OFFICIAL STERLING BALANCES FALL BELOW \$2.881 MILLION POUNDS. IN CURRENT SITUATION, U.K. WOULD HAVE TO LOSE HUNDREDS OF MILLIONS OF POUNDS BEFORE ANY SUPPORT FORTHCOMING, SO BASLE FACILITIES RELATIVELY MEANINGLESS IN DEALING WITH A CRISIS. U.K. NOTES IN ADDITION THAT NOT ALL EC PARTNERS (I.E., FRANCE) PARTICIPATE. IN IMMEDIATE FUTURE, U.K. WOULD NOT EXPECT ANY HELP FROM SHORT-TERM EC CREDIT ARRANGEMENTS, WHICH LARGELY PREEMPTED BY ITALY. LONGER TERM, U.K. OFFICIALS AGAIN LOOK TO REVISED INTERNATIONAL MONETARY SYSTEM TO HELP OBVIATE DIFFICULTIES, OFFER ASSISTANCE AND ARRIVE AT SOLUTIONS THAT WOULD NOT ONLY INVOLVE EC PARTNERS, BUT U.S. AND JAPAN AS WELL.

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